BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ITO CARIANI SAUSAGE COMPANY, INC.)

For Appellant: Victor S. Abe
Attorney at Law

For Respondent: Kendall E. Kinyon
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Ito Cariani Sausage Company, Inc., against proposed assessments of additional franchise tax in the amounts of $10,540.60 and $17,965.42 for the income years ended August 31, 1975 and 1976, respectively.

The issue presented by this appeal is whether appellant has established error in respondent's determination that appellant and its parent, Ito Ham Provisions Co. Ltd. (hereinafter referred to as either "Ito Ham" or "parent"), were engaged in a single unitary business.

Appellant was incorporated under the laws of California in January 1974, and was formed by its parent and sole shareholder, a Japanese corporation engaged in the production of ham, sausage, and related processed meats, to take over a recently acquired salami and processed meat manufacturing business. The acquired business, Cariani Sausage Company, a partnership, had been engaged in the production of processed meat products since 1898.

During the appeal years, five of appellant's six directors were also directors of Ito Ham. The only non-common director, Paul Hayashi, is also the only director who is not a Japanese resident. Mr. Hayashi arranged the sale of Cariani Sausage Company to Ito Ham, and has since acted as a financial consultant to appellant and as the financial liaison between appellant and its parent. One of appellant's three officers, Shorchi Kamese, served as both vice president and treasurer of appellant and as treasurer of Ito Ham. Appellant's president was one of the parent's directors, and Joe Mori, appellant's secretary, was temporarily assigned to the California operation by Ito Ham for the purpose of gaining knowledge with respect to American meat processing.

Alfred Cariani, the managing partner of the predecessor to appellant, remained with the latter upon its incorporation in the capacity of general manager. Mr. Mori assisted Cariani in the purchasing and production departments. Mike Kasahara, who replaced Mori as corporate secretary upon the latter's return to Japan, and Yujiro Sakata also assisted in the production department. Both Mr. Sakata and Mr. Kasahara were employees of the parent corporation on temporary assignment to appellant to promote the exchange of know-how between the affiliated corporations.

Appellant's parent purchases substantial quantities of raw materials from food brokers in the United States for the production of its processed meats. After its acquisition by Ito Ham, appellant acted as a food broker for its Japanese parent. During the respective income years in issue, there were intercompany sales

from appellant to Ito Ham in the total amounts of $1,389,986 and $3,396,202.[1] These sales represented 41 percent of appellant's total sales for the 197% income year and 57 percent of such sales for the subsequent income year. Appellant has asserted that these sales were discontinued after the two years in question, and were transacted through appellant as a form of subsidy to the latter entity from its parent. Ito Ham apparently could have purchased these raw materials from other brokers at a more favorable price, but elected to utilize appellant as its broker so as "to enable [it] to earn some commissions in difficult financial circumstances."

Due to the distance separating it from its Japanese parent, appellant is-responsible for the provision of its own accounting and legal needs. Mr. Hayashi frequently reports to Ito Ham on the progress of appellant, and monthly financial reports are submitted to the parent. Finally, while both entities have a common corporate name, i.e., "Ito," they do not share the same logo or engage in joint advertising.

Appellant computed its income for the income years in issue by use of the separate accounting method. Upon audit, however, respondent determined that appellant and its parent were engaged in a single unitary business and that appellant's income, derived from a California source, should be determined by formula apportionment of the two entities' combined income. Appellant protested, and the denial of its protest led to this appeal.

When a taxpayer derives income from sources both within and without California, it is required to measure its California franchise tax liability'by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) 'If the taxpayer is engaged in a unitary business with an affiliated corporation, the amount of income attributable to California sources must be determined. by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (See Edison California Stores, Inc. v.

1/ These amounts include fr'eight costs of $11,810 and $20,698 .for the respective income years in issue.

McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947); John Deere Plow Co. v. Franchise Tax Board, 38 Cal.2d 2147238 P.2d 5691 (1951), app. dism., 343 U.S. 939 [96 L.Ed. 1345] (1952).)

The California Supreme Court has determined that a unitary business is definitely established by the existence of: (1) unity of ownership; (2) unity of operation as evidenced by centra-1 purchasing, advertising, accounting, and management divisions; and (3) unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664, 678 [111 P.2d 334] (1941), aff'd., 315 U.S. 501 [86 L.Ed. 991] (1942).) The court has also held that a business is unitary when the operation of the business within California contributes to or is dependent upon the operation of the business outside the state. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at 481.) These principles have been reaffirmed in more recent cases. (Superior Oil Co. v. Franchise Tax Board, 60 Cal.2d 406 [34 Cal.Rptr. 545, 386 P.2d 33] (1963); Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal.2d 417 [34 Cal.Rptr. 552, 386 P.2d 40] (1963).) The existence of a unitary business may be established if either the three unities or the contribution or dependency test is satisfied.

In concluding that appellant and its parent were engaged in a single unitary business, respondent relied upon the following factors: an integrated executive force which controlled appellant's major policy decisions; total ownership of appellant by its parent; the operation of similar businesses and the sharing of know-how between the two entities; intercompany personnel transfer for training purposes; substantial intercompany product flow effectively providing a financial subsidy from Ito Ham to appellant; and the sharing of a common corporate name. In numerous prior cases the unitary features relied upon by respondent, when viewed in the aggregate, have demonstrated a degree of mutual dependency or contribution sufficient to compel the conclusion that a unitary business existed. (See, e.g., Chase Brass & Copper Co. v. Franchise Tax Board, 10 Cal.App.3d 496 [87 Cal.Rptr. 239], app. dism. and cert. den., 400 U.S. 961 [27 L.Ed.2d 381] (1970); Appeal of Data General Corporation, Cal. St. Bd. of Equal., July 26, 1982; Appeal of Credit Bureau- Central, Inc., Cal. St. Bd. of Equal., Feb. 2, 1981; Appeal of Shachihata, Inc., U.S.A., Cal. St. Bd. of Equal., Jan. 9, 1979.)

Respondent's determination that appellant is engaged in a unitary business with its parent is presumptively correct. (Appeal of John Deere Plow Co. of Moline; Cal. St. Bd. of Equal., Dec. 13, 1961.) The burden to produce sufficient credible evidence to negate the existence or significance of the unitary connections relied upon by respondent and thereby overcome the presumptive correctness'of respondent's determination is upon appellant. (See Appeal of Saga Corporation, Cal. St. Bd. of Equal., June 29, 1982.) Although appellant contends that its business is "separate and distinct" from that of its parent, it has offered no evidence in support of its position, Thus, in the absence of some compelling reason to invalidate respondent's determination, we must conclude that appellant has failed to carry its burden of proof and that respondent's action in this matter was correct.

In support of its position challenging the subject assessments, appellant has advanced three constitutional arguments:. (1) the tax is measured in part by the income of the foreign parent which is contrary to the due process clause of the Fourteenth Amendment to the United States Constitution; (2) imposition of the tax constitutes a restraint on foreign commerce in violation of the commerce clause of the United States Constitution; and (3) requiring a combined report by appellant and its Japanese parent violates the Treaty of Friendship, Commerce and Navigation (4 U.S.T. 2063 (April 2, 1953)) between the United States and Japan, as well as the Convention between the United States and Japan for the Avoidance of Double Taxation (23 U.S.T. 967 (March 8, 1971)). The identical arguments were raised by the taxpayer in Appeal of Shachihata, Inc., U.S.A., decided by this boa-rd January 9, 1979. As we pointed out in that appeal (and in other appeals cited therein), this board has a well-established policy of abstention from deciding constitutional questions in an appeal involving proposed assessments of additional tax. This policy is based upon the absence of any specific' statutory authority which would allow the Franchise Tax Board to obtain judicial review of a decision in an appeal of this type, and our belief that such review should be available for questions of constitutional importance. This policy properly applies in the present appeal. We do note, however, that. objections substantially similar to those set forth by appellant were considered and rejected in Container Corp. of America v. Franchise Tax Board, 117 Cal.App.3d 988 [173 Cal.Rptr. 121] (1981), prob. juris. noted, May 3, 1982, -- U.S. -- (Dock. No. 81-523).

In addition to the constitutional arguments noted above, appellant also contends that it is engaged in a distinctly different business from that of its parent, and that the aforementioned sales to Ito Ham constituted such a small percentage of the latter's total purchases as to be of relatively little significance. Upon careful review of the record of this appeal, we conclude that these arguments are without merit.

Initially, we observe that appellant has failed to demonstrate that there is any substantive difference between its business, i.e., the manufacture of Italian-style salami and other processed meats, and that of its parent, which specializes in the production of ham and related processed meats. While not identical in all aspects, the affiliated corporations operate businesses sufficiently similar to support a finding of unity in view of the entire record of this appeal. (See Appeal of Credit Bureau Central, Inc., supra; Appeal of Pup 'n' Taco Drive Up, Cal. St. Bd. of Equal., March 2, 1977.) Finally, the fact that appellant's sales to Ito Ham constituted only a minor portion of the latter's total purchases does not militate against finding that intercompany product flow is one of the unifying factors present in this appeal, since 41 percent and 57 percent of appellant's total sales were made to Ito Ham during the years in issue. The obvious significance of these sales is even more compelling given appellant's statement that they were designed, at least in part, as a manner for the parent to finance appellant. Intercompany financing constitutes a unitary factor. (See Appeal of L & B Manufacturing Company, Cal. St. Bd. of Equal., Nov. 18, 1980; Appeal of Beecham, Inc., Cal. St. Bd. of Equal., March 2, 1977.)

For the reasons set forth above, respondent's action in this matter will be sustained.

Appeal of Ito Cariani Sausage Company, Inc.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section.25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Ito Cariani Sausage Company, Inc., against proposed assessments of additional franchise tax in the amounts of $10,540.60 and $17,965.42 for the income years ended August 31, 1975 and 1976, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 5th day of April , 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M. Bennett , Chairman

Conway II. Collis , Member

Ernest J. Dronenburg, Jr. , Member

Richard Nevins , Member

Walter Harvey* , Member

*For Kenneth Cory, per Government Code Section 7.9